APPENDIX A

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 81-2025

Robert M. Snell and Rosalie J. Snell,
husband and wife,

Appellants,

vs.

United States of America,

Appellee.

Appeal from the United States District Court
for the District of Nebraska

Submitted: May 18, 1982
Filed: June 18, 1982

Before BRIGHT and McMILLIAN, Circuit Judges, and HARRIS,* Senior District Judge.

McMILLIAN, Circuit Judge.

Robert M. Snell and Rosalie J. Snell, husband and wife, appeal an order entered in the District Court[1] for the District of Nebraska granting the government's motion for summary judgment in the Snells' tax refund suit based on the district court's finding that a taxpayer is not entitled to, as a deduction, partnership losses which had accrued prior to the taxpayer's entry into the partnership. For reversal the Snells argue that summary judgment was inappropriate because such retroactive allo-

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*The Honorable Oren Harris, United States Senior District Judge for the Eastern and Western Districts of Arkansas, sitting by designation.

[1]The Honorable Warren K. Urbom, Chief Judge, United States District Court for the District of Nebraska.

cations are not unallowable as a matter of law, but rather, they are unallowable only when the government proves that entry into the partnership was a sham or for tax avoidance. After a careful examination of the law and the record, we reject the Snells' contentions as contrary to law. Accordingly, we affirm.

The facts are not in dispute. In late December 1975, Robert Snell acquired a 49 percent interest in a Nebraska partnership in exchange for a contribution of $375,000. This acquisition reduced the interest of each of the original partners from 33⅓ per cent to 17 percent. At that time the original partners and Snell entered into an Amendment and Restatement of Partnership under which Snell was accorded 90 percent of the partnership's profits or losses for the taxable year ending December 31, 1975, and prospectively for the taxable years 1976, 1977 and 1978. For the taxable year 1979 and thereafter, Snell was to receive 49 percent of the partnership's profits or losses.

On its federal income tax return for 1975, the partnership reported a loss of $442,408. The Snells claimed 90 percent of this loss and carried it back to the years 1972, 1973 and 1974 and received a refund of all taxes paid for those years. Thereafter, the Internal Revenue Service (IRS) audited the 1975 partnership return and determined that the partnership's net operating loss was less than $442,408, and that the Snells were only entitled to report 49 percent of the partnership's loss, rather than 90 percent. In accordance with these determinations, tax deficiencies were assessed by the IRS and paid by the Snells. The Snells then initiated the present action to recover the amounts paid. The government moved for summary judgment.

The district court granted the government's motion based on its findings that a retroactive allocation to a newly admitted partner was prohibited under § 706(c)(2) of the Internal Revenue Code (the Code), relating to the taxation of partners and partnerships, and also by the allocation of income doctrine. *Snell v. United States*, No. CV 80-L-57 (D. Neb. Sept. 14, 1981), slip op, at 2-3. The court noted that this was the same result reached by all the courts which have decided the issue, *citing Rodman v. Commissioner*, 542 F. 2d 845, 858 (2d Cir. 1976); *Marriott v. Commissioner*, 73 T. C. 512 (1981), *appeal pending*, No. 81-4387 (5th Cir.); *Moore v. Commissioner*, 70 T. C. 1024 (1978).

When reviewing the district court's entry of summary judgment, this court applies the same standard as the district court. 10 C. Wright & A. Miller, Federal Practice and Procedure § 2716 (1973). Under Fed. R. Civ. P. 56(c), the motion for summary judgment should be sustained "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law."

This circuit has repeatedly emphasized the drastic nature of the summary judgment remedy. It should not be granted unless the moving party has established the right to a judgment with such clarity as to leave no room for controversy. *See Jackson v. Star Sprinkler Corp.*, 575 F. 2d 1223, 1226 (8th Cir. 1978); *New England Mutual Life Insurance Co. v. Null*, 554 F. 2d 896, 901 (8th Cir. 1977; *Robert Johnson Grain Co. v. Chemical Interchange Co.*, 541 F. 2d 207, 209 (8th Cir. 1976). The moving party

must overcome a heavy burden and the evidence is viewed in the light most favorable to the nonmoving party. The court must give the nonmoving party the benefit of all reasonable inferences to be drawn from the facts. *Adickes v. S. H. Kress & Co.*, 398 U. S. 144, 158-59 (1970); *Jackson v. Star Sprinkler Corp.*, 575 F. 2d at 1126. "However, this Circuit recognizes the remedy's salutory purpose of avoiding useless and time consuming trials." *Butler v. MFA Life Insurance Co.*, 591 F. 2d 448, 451 (8th Cir. 1979), *citing Percival v. General Motors Corp.*, 539 F. 2d 1126, 1129 (8th Cir. 1976); *Lyons v. Board of Education*, 523 F. 2d 340, 347 (8th Cir. 1975).

In the present case the district court relied on the Code provisions governing the taxation of partners and partnerships. Specifically, it found that § 706(c)(2)(B)[2] was applicable and that it precluded retroactive allocation of partnership losses or profits to newly admitted partners. That section provides that when a partner's interest is "reduced" during the taxable year, the partnership's tax year is not interrupted, but the individual partner must take this reduction into account in calculating his share of partnership items listed in § 702(a) of the Code, which includes profits or losses.

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[2]Section 706(c)(2)(B) provides:

(B) *Disposition of less than entire interest.*

The taxable year of a partnership shall not close . . . with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced, but such partner's distributive share of items described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the year.

The district court reasoned that the entry of a new partner caused the original partners to have a reduced interest within the meaning of § 706(c)(2)(B). The district court further reasoned that because the statute would bar the original partners from sharing disproportionately in the partnership's losses or profits after the entry of the new partner, the statute would similarly bar the new partner from sharing disproportionately in profits or losses which accrued prior to his entry.

On appeal the Snells argue that § 706(c)(2)(B) is inapplicable because the term "reduce" only refers to reductions resulting from the sale, exchange or liquidation of a partner's interest and does not encompass entry of a new partner. Therefore, the Snells reason, there is no requirement that there be any adjustment made in the partners' shares of losses or profits due to their varying interests. In support of this argument the Snells reason that the values of the original partners' shares were not reduced because of the Snells' capital contribution. We conclude that this argument has no merit.

Section 706(c)(2)(B) of the Code refers to a reduction in interest rather than a reduction in value. It is undisputed that each original partner's interest was reduced from 33⅓ percent to 17 percent. In addition, § 706(c),[3] which sets forth the general rule as to the con-

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[3]Section 706(c) provides:

(c) *Closing of partnership year.*

(1) *General rule*

Except in the case of a termination of a partnership . . . the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

sequences of a change in partnership membership during the taxable year, refers not only to the sale, exchange or liquidation of a partner's interest but also to "the entry of a new partner." Reading § 706(c) in its entirety, as it should be read, we affirm the district court's finding that the term "reduced" in § 706(c)(2)(B) applied to the admission of new partners in exchange for a contribution to capital. *See Rodman v. Commissioner* 542 F. 2d at 858 (§ 706 (c) (2) (B) applies to the admission of new partners as well as to the transfer by a partner of a partnership interest).

The Snells next argue that even if § 706(c)(2)(B) is applicable, it is overridden by the mandate in § 704(a) that a partner's distributive share of the partnership's income or loss is to be determined by the partnership agreement. The Snells reason that because § 706(c)(2)(B) is not part of § 704(a), it is operative only when the partners do not have a partnership agreement which provides for the distribution of the partnership's income and loss.

The district court properly rejected this argument on the basis that § 706(c)(2)(B) is also mandatory, and its language is not limited to situations in which there is no partnership agreement to control the determination of a partner's distributive share. The district court noted that the same argument had been considered and rejected in *Rodman v. Commissioner,* 542 F. 2d 845, *Marriott v. Commissioner,* 73 T. C. 35, and *Moore v. Commissioner,* 70 T. C. 1024. The Snells have not cited any authority in support of their argument on appeal and we conclude that it has no merit.

As a second, independent ground for its decision the district court held that the assignment of income doctrine bars the allocation of pre-entry profits or losses to a new partner even if the Code is silent on this point.

On appeal the Snells argue that the doctrine has no relevance to allocations among partners because Congress intended partners to have flexibility in their profit or loss allocations as evidenced by § 761 of the Code, which gives current partners the right to adjust their respective allocations.

The district court properly rejected this argument, reasoning that § 761 did not apply to newly admitted partners because it is subject to the tax avoidance caveat of § 704(b).

We agree with the district court. Section 761 does give current partners the right to adjust their respective allocations to accurately reflect the fruitfulness, or lack thereof, of each partner's contribution of capital or services to the partnership. In that case the current partners have sustained profit or loss during the taxable year and all that remains is to determine the amount each will bear. Section 761 permits a change in this determination from that provided in the partnership agreement. However, the allocations may not be used as a vehicle to escape tax liability. § 704(b)(2); *Smith v. Commissioner*, 331 F. 2d 298, 301 (7th Cir. 1964). Therefore, § 761 has no relevance to an allocation of profit or loss to an individual who was not even a member of the partnership when that loss or profit was sustained.

We have considered the Snells' other arguments and conclude that they have no merit.

Accordingly, the judgment of the district court is affirmed.

A true copy.

ATTEST:

CLERK, U. S. Court of Appeals, Eighth Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
For the District of Nebraska

CV80-L-57

ROBERT M. SNELL and ROSALIE J. SNELL, husband and wife,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

ORDER

Entered on Docket: September 15, 1981
Filed: September 15, 1981

Pursuant to the accompanying memorandum of this date,

IT HEREBY IS ORDERED AND ADJUDGED that summary judgment for the defendant on the plaintiffs' claim is granted.

Dated September 14, 1981.

BY THE COURT
/s/ Warren K. Urbom
Chief Judge

MEMORANDUM

This is an action seeking refund of federal income taxes paid by the plaintiffs for their taxable years 1972, 1973, and 1974. The defendant has moved for summary judgment, filing 5. The sole issue to be decided on this motion is whether a taxpayer who acquired an interest in a partnership can offset his taxable income by losses incurred by the partnership prior to the acquisition.

The material facts relevant to the resolution of this issue are not in dispute. Sometime near the end of 1975 the plaintiff Robert M. Snell acquired a 49 per cent interest in a Nebraska partnership in exchange for a contribution of $375,000.00. This acquisition reduced the interest of each of the three original partners from 33⅓ per cent to 17 per cent. On its federal income tax return for 1975 the partnership reported a loss of $442,408.00. Pursuant to an amendment and restatement of the partnership agreement, the plaintiffs claimed 90 per cent of this loss on their joint income tax return as Mr. Snell's distributive share of the partnership loss. The plaintiffs carried back this loss to the years 1972, 1973 and 1974 and received a refund of all taxes paid for those years. Thereafter, the Internal Revenue Service audited the 1975 partnership return and determined that the partnership's net operating loss was less than $442,408.00 and that the plaintiffs were entitled to report only 49 per cent of the partnership's loss, not 90 per cent. In accord with these determinations, tax deficiencies were assessed by the IRS and paid by the plaintiff. By this action the plaintiffs seek to recover the amounts paid.

The defendant contends by its motion for summary judgment that regardless of whether the plaintiffs are entitled to 90 per cent or 49 per cent of the partnership loss for the year 1975, the only portion of the loss which they can claim is that which occurred after the acquisition of an interest in the partnership. The parties are in agreement that if the defendant prevails on this issue, the plaintiffs are not entitled to a refund.

The defendant contends that the plaintiffs cannot claim any of the partnership's losses which occurred prior

to Mr. Snell's entry as a partnership, for two reasons: it could constitute an assignment of income, and it would be inconsistent with the provisions governing the taxation of partners and partnerships.

I. Statutory provisions.

The following partnership code provisions are relevant to a resolution of the issue presented here. 1/ Section 702(a) contains the general rule that each partner must take into account in computing his income tax his distributive share of the partnership's income, gain, loss, deduction, and credit. Section 704(a) provides that except as otherwise provided in that section, a partner's "distributive share" of income, gain, loss, deduction, or credit shall be determined by the partnership agreement. As defined by § 761(a), a partnership agreement consists of any modifications made prior to or at the time prescribed by law for the filing of the partnership return for the taxable year.

Section 706(c)(1) sets forth the general rule that, except as provided in paragraph (2) of the section, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, or the liquidation, sale or exchange of a partner's interest in the partnership. Section 706(c)(2)(B) provides that with respect to a partner who sells or exchanges less than his entire interest in the partnership or a partner whose interest is reduced, the taxable year of the partnership shall not close as to that partner, but his distributive share of the partnership income and losses shall be determined "by taking into account his varying interest in the partnership during the taxable year."

Sections 704(a) and 761(a), read together, allow partners who were members of a partnership for the full year to modify the partnership agreement at any time prior to the time for filing a return to shift income and losses among themselves as they see fit. Such modifications relate back to the beginning of the partnership year. *Smith v. Commissioner*, 331 F. 2d 298, 301 (C. A. 7th Cir. 1964); *Foxman v. Commissioner*, 41 T. C. 535, 554 (1964), aff'd 352 F. 2d 466 (C. A. 3rd Cir. 1965). The question here is whether § 706(c)(2)(B) prohibits the same "retroactive allocations" as to one who becomes a partner after the income and losses being reallocated have been incurred. 2/ *Rodman v. Commissioner*, 542 F. 2d 845, 858 (C. A. 7th Cir. 1964), holds that it does; and the United States Tax Court, citing *Rodman* as precedent, has held the same in *Moore v. Commissioner*, 70 T. C. 1024, 1031-1033 (1978), and *Marriott v. Commissioner*, 73 T. C. 35 (1980).

The plaintiffs argue that *Rodman*, *Moore*, and *Marriott* are distinguishable, in that each of those cases involved a sale or exchange of less than an entire interest in a partnership by one or more preexisting partners, while in the present case the plaintiff contributed capital to the partnership in exchange for a 49 per cent interest. The plaintiffs argue that § 706(c)(2)(B) is not applicable to a capital contribution situation.

Section 706(c)(2)(B) refers not only to a partner who "sells or exchanges less than his entire interest," but also to a partner whose interest is "reduced." 3/ The plaintiffs contend that the definition of "reduced" is limited to a partial liquidation of a partner's interest, and in support of this contention cite subpart (A) of § 706(c)

(2) which sets forth the consequences of a disposition of a partner's entire interest in the partnership in only two events—the sale or exchange of the interest or the liquidation of a partner's entire interest. From this, the plaintiffs argue that subpart (B) of § 706(c)(2) should be construed to deal with the disposition of less than an entire partnership interest in the same two limited situations. However, in so arguing the plaintiffs overlook § 706 (c), which sets forth the general rule as to the consequences of a change in partnership membership during the taxable year. That section refers not only to the sale, exchange or liquidation of a partner's interest, but also to "the entry of a new partner." The entry of a new partner via a contribution of capital in exchange for an interest in the partnership would presumably result in a reduction of the other partners' interests, and § 706(c)(2)(B) provides that when a partner's interest is reduced, that partner's distributive share of the items described in § 706(a) shall be determined by taking into account the partner's varying interests in the partnership during the taxable year. Reading § 706(c) in its entirety—as it should be read—I conclude that the term "reduced" in § 706(c)(2)(B) includes a contribution to the capital of a partnership.

The plaintiff also argues that § 706(c)(2)(B) is inapplicable to this case, because the section does not apply to § 706(a)(9)—taxable income or loss—allocations. Under § 706(c)(2)(B), the "varying interests" rule governs the determination of a partner's distributive share of "items described in section 702(a)." While it has never been judicially resolved, it has been suggested that the term "items," as used in § 704(b) of the partnership code, ap-

plies only to particular items of income, gain, loss, deduction, or credit, and not to taxable income and loss. 4/ See *Jean v. Kresser*, 54 T.C. 1621, 1631, n.5 (1970) (Where the court indicated support for this conclusion but did not resolve the issue); *Holladay v. Commissioner*, 72 T. C. 571, 587 (1979); and *Boynton v. Commissioner*, 72 T. C. 1147, 1158 (1970) (where the commissioner conceded that § 704 (b) (2) has no application to § 702 (a) (9) "bottom-line" losses); S. Rep. No. 1622, 83rd Cong., 2d Sess., 1954 U. S. Code Cong. & Admin. News 5020. However, it is the structure of § 704 (b) itself and the language of the legislative history on that section which lend support to such a suggestion. *Jean v. Kresser*, supra. Section 704(b) says that where the partnership agreement does not provide specifically for the manner of sharing any item of income, gain, loss, deduction or credit, then each partner's distributive share of that item shall be "determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a) (9)." There is no comparable language in either § 706(c) (2)(B) or its legislative history which would provide support for a similar interpretation of the term "items" as used in that section; rather, § 706(c)(2)(B) refers generally to "items described in section 702(a)." This same phrase as used in § 706(c)(2)(A) has been interpreted as including taxable income and loss. Treas. Reg. § 1.706-1(c)(2)(ii). There is no reason for giving the term a different interpretation as it is used in § 706(c)(2)(B).

Finally, the plaintiffs argue that even if § 706(c)(2) (B) is deemed to be applicable to the present situation, it is overriden by the mandate in § 704(a) that a partner's distributive share of the partnership's income or loss be

determined by the partnership agreement unless otherwise provided by that section. 5/ The plaintiffs argue that since § 706(c)(2)(B) is not a part of § 704(a), it is operative only when the partners do not have a partnership agreement which provides for a distribution of the partnership's income and loss. This argument overlooks the fact that § 706 (c) (2) (B) is also mandatory, and nowhere within its language is it limited to situations where there is no partnership agreement to control the determination of a partner's distributive share. Furthermore, the argument of the plaintiffs was considered and rejected in *Rodman v. Commissioner*, supra, *Moore v. Commissioner*, supra, and *Marriott v. Commissioner*, supra.

II. Assignment-of-income doctrine.

The above interpretation of § 706(c)(2)(B) is confirmed by a consideration of the assignment-of-income doctrine. The "first principle of income taxation" is that income must be taxed to him who earns it and loss must be deducted by him who suffers it. *United States v. Basye*, 410 U.S. 411, 447 (1973); *Commissioner v. Culbertson*, 337 U.S. 733, 739-749 (1950); *Helvering v. Horst*, 311 U.S. 112, 116 (1940); *Lucas v. Earl*, 281 U.S. 111, 114-115 (1930). In accordance with these principles, Congress enacted §§ 704(a) and 761(c) to allow the members of a partnership to allocate retroactively the gains and losses of the partnership to accurately reflect the fruitfulness, or lack thereof, of each partner's contribution of capital or services to the partnership. This is so, as long as the allocations are not a vehicle to escape tax liability. Section 704(b)(2); *Smith v. Commissioner*, 331 F. 2d 298,

301 (C.A. 7th Cir. 1964). Section 760(c)(2)(B) furthers the "first principle of income taxation" by forbidding allocations of partnership income or loss to one who joins a partnership *after* such income or loss has been incurred. Because none of the newly admitted partner's contributed capital or services generated the partnership income or loss incurred prior to his entry, the newly admitted partner is not eligible to share in such income or loss. To hold otherwise would be contrary to the assignment-of-income doctrine.

For the reasons stated above, I conclude that a taxpayer who acquires an interest in a partnership cannot offset his taxable income by losses incurred by the partnership prior to the acquisition, whether the acquisition be by purchase from an individual partner or by contribution of capital to the partnership.

An order will be entered granting the defendant's motion for summary judgment.

Dated September 14, 1981.

BY THE COURT
/s/ Warren K. Urbom
Chief Judge

Footnote 1/ All references to section numbers are to sections contained in Title 26 of the United States Code, unless otherwise designated.

Footnote 2/ The Tax Reform Act of 1976, Pub. L. 94-455, sec. 213 (c), (d) and (f), 90 Stat. 1547-1548, expressly prohibits the type of retroactive allocation at issue in this case. However, in the committee reports accompanying the Act, Congress expressed its intention

that no inference was to be drawn as to the propriety or impropriety of such retroactive allocations prior to 1976. Rather, Congress stated that under the law at that time it was "unclear" whether § 706(c)(2)(B) required the inclusion of income and loss according to a partner's varying interests during the year where the partner's interest was acquired directly from the partnership. H. Rep. No. 94-658, 94th Cong., 2d Sess. 122-125, 1976 U. S. Code Cong. & Admin. News 3019, 3020; S. Rep. No. 94-938, 94th Cong., 2d Sess. 94-98, 1976 U. S. Code Cong. & Admin. News 3533, 3534.

Footnote 3/ Section 706(c)(2)(B) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(c)(1), 90 Stat. 1547, by substituting "or with respect to a partner whose interest is reduced (whether by entry of a new partner, partial liquidation of a partner's interest, gift, or otherwise)" for "or with respect to a partner whose interest is reduced."

Footnote 4/ Section 704(b) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(d), 90 Stat. 1548, to read:

> "A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), . . ."

As amended, the section does apply to taxable income and loss of the partnership.

Footnote 5/ Section 704(a) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(c)(2), 90 Stat. 1548, by substituting "except as otherwise provided in this chapter" for "except as otherwise provided in this section."

APPENDIX C

RELEVANT PROVISIONS OF THE INTERNAL REVENUE CODE, SUBCHAPTER K, AS IN EFFECT FOR 1975.

STATUTES INVOLVED

This case involved certain sections of Subchapter K of the Internal Revenue Code of 1954 as in effect for 1975. The following is the most relevant provisions of Subchapter K that are applicable to this case.

I.R.C. § 702. INCOME AND CREDITS OF PARTNER.

(a) General Rule—In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

(3) gains and losses from sales or exchanges of property described in Section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in Section 170(c)),

(5) dividends with respect to which there is provided an exclusion under Section 116, or a deduction under Part VIII of Subchapter B,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) partially tax-exempt interest on obligations of the United States or on obligations of instrumentalities of the United States as described in section 35 or section 242 (but, if the partnership elects to amortize the premiums on bonds as provided in section 171, the amount received on such obligations shall be reduced by the reduction provided under section 171(a)(3)),

(8) other ITEMS* of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary or his delegate, and

(9) taxable income or loss, exclusive of ITEMS requiring separate computation under other paragraphs of this subsection.

(b) Character of ITEMS Constituting Distributive Share—the character of any ITEM of income, gain, loss deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such ITEM were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) Not Relevant.

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*Emphasis is added for the Court's convenience to words which are the focal point of the controversy.

I.R.C. § 703. PARTNERSHIP COMPUTATIONS.

(a) Income and Deduction—The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that—

(1) the ITEMS described in section 702(a) shall be separately stated, and

(2) Not Relevant.

(b) Not Relevant.

I.R.C. § 704. PARTNER'S DISTRIBUTIVE SHARE.

(a) Effect of Partnership Agreement—A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

(b) Distributive Share Determined by Income or Loss Ratio—A partner's distributive share of any ITEM of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a)(9), for the taxable year, if—

(1) the partnership agreement does not provide as to the partner's distributive share of such ITEM, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such ITEM is the avoidance or evasion of any tax imposed by this subtitle.

(c) Not Revelant.

(d) Not Relevant.

(e) Family Partnerships—

(1) Recognition of Interest Created by Purchase or Gift—A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) Distributive Share of Donee Includible in Gross Income—In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) Purchase of Interest by Member of Family—For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

I.R.C. § 706. TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

(a) Year in Which Partnership Income is Includable—In computing the taxable income of a partner for

a taxable year, the inclusions required by Section 702 and Section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

(b) Not Relevant.

(c) Closing of Partnership Year—

(1) General Rule—Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not CLOSE as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Partner Who Retires or Sells Interest in Partnership—

(A) Disposition of Entire Interest—The taxable year of a partnership shall CLOSE—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

(ii) with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies shall not CLOSE prior to the end of the partnership's taxable year.

Such partner's distributive share of ITEMS described in section 702(a) for such year shall be determined, under regulations prescribed by the Secretary or his delegate, for the period ending with such sale, exchange, or liquidation.

(B) Disposition of Less than Entire Interest—The taxable year of a partnership shall not CLOSE (other than at the end of partnership's taxable year as determined under subsection (b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is REDUCED, but such partner's distributive share of ITEMS described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the taxable year.

I.R.C. § 708. CONTINUATION OF PARTNERSHIP.

(a) General Rule—For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated.

(b) Termination—

(1) General Rule—For purposes of subsection (a), a partnership shall be considered as terminated only if—

(A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or

(B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

(2) Special Rules—Not Relevant.

I.R.C. ¶ 736. PAYMENTS TO A RETIRING PARTNER OR A DECEASED PARTNER'S SUCCESSOR IN INTEREST.

(a) Payments Considered as Distributive Share or Guaranteed Payment—Payments made in liquidation of

the interest of a retiring partner or a deceased partner shall, except as provided in Subsection (b), be considered —

(1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or

(2) as a guaranteed payment described in Section 707(c) if the amount thereof is determined without regard to the income of the partnership.

(b) Payments for Interest in Partnership—

(1) General Rule—Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments (other than payments described in Paragraph (2)) are determined, under regulations prescribed by the Secretary or his delegate, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under Subsection (a).

(2) Special Rules—For purposes of this Subsection, payments in exchange for an interest in partnership property shall not include amounts paid for—

(A) unrealized receivables of the partnership (as defined in Section 751 (c)), or

(B) good will of the partnership, except to the extent that the partnership agreement provides for a payment with respect to good will.

(C) Did not exist in 1975.

I.R.C. § 741. RECOGNITION AND CHARACTER OF GAIN OR LOSS ON SALE OR EXCHANGE.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in Section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

I.R.C. § 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) Sale or Exchange of Interest in Partnership—The amount of any month, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership which have appreciated substantially in value, shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

(b) Certain Distributions Treated as Sales or Exchanges—

(1) General Rule—To the extent a partner receives in a distribution—

(A) partnership property described in Subsection (a)(1) or (2) in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in Subsection (a)(1) or (2) in exchange for all or part of his interest in partnership property described in Subsection (a)(1) or (2),

such transaction shall, under regulations prescribed by the Secretary or his delegate be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution).

(2) Exceptions—Paragraph (1) shall not apply to—

(A) a distribution of property which the distributee contributed to the partnership, or

(B) payments, described in Section 736(a), to a retiring partner or successor in interest of a deceased partner.

(c) Unrealized Receivables—For purposes of this Subchapter, the term "unrealized receivables" includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

(1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(2) services rendered, or to be rendered. For purposes of this section and Sections 731, 736 and 741, such term also includes mining property (as defined in Section 617(f)(2)), Section 1245 property (as defined in Section 1245(a)(3)), Section 1250 property (as defined in Section 1250(c)) farm recapture property (as defined in Section 1251(e)(1)), and farm land (as defined in Sec-

tion 1252(a)), the extent of the amount which would be treated as gain to which Section 617(d)(1), 1245(a) or 1250(a), 1251(c) or 1252(a) would apply if (at the time of the transaction described in this Section or Section 731, 736, or 741, as the case may be) such property had been sold by the partnership at its fair market value.

(d) Inventory Items Which Have Appreciated Substantially in Value—

(1) Substantial Appreciation—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds—

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory Items—For purposes of this Subchapter the term "inventory items" means—

(A) property of the partnership of the kind described in Section 1221(1),

(B) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in Section 1231,

(C) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under Subsection (a) of Section 1246 (relating to gain on foreign investment company stock), and

(D) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in Subparagraph (A), (B) or (C).

I.R.C. § 761. TERMS DEFINED.

(c) Partnership Agreement—For purposes of this subchapter, a partnership agreement includes an modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) Liquidation of a Partner's Interest—For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partners' entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership.

APPENDIX D

FEDERAL RULES OF CIVIL PROCEDURE—SUMMARY JUDGMENT

RULE 56. SUMMARY JUDGMENT.

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of

20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion And Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(d) Case Not Fully Adjudicated on Motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if praciable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that

appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him.

(f) When Affidavits Are Unavailable. Should it appear from the affidavits of a party opposing the motion that he cannot for reasons stated present by affidavit facts essential to justify his opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other as is just.

(g) Affidavits Made in Bad Faith. Should it appear to the satisfaction of the court at any time that any of the affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused him to incur, including reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.